

**EXPLANATORY MEMORANDUM TO
THE INCOME TAX ACT 2007 (AMENDMENT) (No. 3) ORDER 2007
2007 No. 3506**

1. This explanatory memorandum has been prepared by the Commissioners for Her Majesty's Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.
2. **Description**
 - 2.1 The Order makes amendments to the Income and Corporation Taxes Act 1988 ("ICTA 1988") and the Income Tax Act 2007 ("ITA 2007").
 - 2.2 The amendments come into force on 3rd January 2008 and have effect for income tax and capital gains tax for the tax year 2007-2008 onwards and for corporation tax for accounting periods ending after 5 April 2007.
3. **Matters of special interest to the Select Committee on Statutory Instruments**
 - 3.1 The Order makes consequential amendments to section 217 of ICTA 1988 that were inadvertently omitted from ITA 2007. It also corrects six minor errors in ITA 2007. These errors concern sections 396, 540, 816 and 874 of, and paragraphs 193 and 238(5)(b) of Schedule 1 to, ITA 2007.
 - 3.2 The Order is made under sections 1028 and 1029 of ITA 2007 which allow amendments that are consequential upon ITA 2007 and amendments that undo changes, made by ITA 2007, in the effect of the law.
 - 3.3 The amendments that are contained in the Order take effect retrospectively. The authority for this is contained in sections 1028(4) and 1029(4) of ITA 2007.
4. **Legislative Background**
 - 4.1 ITA 2007 completed the main work of the Tax Law Rewrite project in relation to the rewrite of income tax. The powers in sections 1028 and 1029 were included to ensure that minor amendments could be made quickly and easily and without recourse to a Finance Bill.
 - 4.2 At the meeting of the Joint Committee on Tax Law Rewrite Bills on 24 January 2007 the then Financial Secretary to the Treasury, John Healey, gave an assurance that the power at section 1029 would not be used without the agreement of the Tax Law Rewrite Consultative and Steering Committees. Equally, the project is committed, as appropriate, to obtaining the agreement of those Committees to the exercise of the power contained in section 1028. Agreement has been obtained to the exercise of these powers.
5. **Extent**

The Order applies to the whole of the United Kingdom.

6. European Convention on Human Rights

The Financial Secretary to The Treasury considers that the provisions of the Income Tax Act 2007 (Amendment) (No. 3) Order 2007 are compatible with the Convention rights.

7. Policy background

7.1 The Tax Law Rewrite project was established in 1996. ITA 2007 was the project's fourth Act and the third relating to income tax.

7.2 The project's aim is to rewrite the United Kingdom's primary direct tax legislation to make it clearer and easier to use, without changing the law (apart from minor identified changes).

7.3 The amendments made by the Order concern the following.

7.3.1 Section 214(1)(b) of ICTA 1988 is rewritten in section 928 of ITA 2007, but the references to section 214(1)(b) and section 214 in section 217(2) of ICTA 1988, and the reference to section 214 in section 217(3) were overlooked. By virtue of paragraph 5 of Schedule 2 to ITA 2007 a reference to a provision in ICTA 1988, which has been rewritten for income tax purposes, is read as including a reference to the equivalent rewritten provision in ITA 2007. But it is preferable for ICTA 1988 to be consequentially amended and article 2(2) of the Order makes the necessary amendments. The amendments include references to sections 949(2) and 950(2) in Chapter 15 of Part 15 of ITA 2007 and to section 963(2) in Chapter 16 of that Part, which rewrite provisions of section 350 of, and paragraphs 2 and 9 of Schedule 16 to, ICTA 1988 which are applied by section 214(1)(b) of ICTA 1988.

7.3.2 Paragraph 238(5)(b) of Schedule 1 to ITA 2007 makes consequential amendments to paragraph 4(4) of Schedule 23A to ICTA 1988 so that it applies only for the purposes of corporation tax. Paragraph 4(4) of Schedule 23A to ICTA 1988 previously referred by implication to the provisions of paragraph 4(3) of that Schedule. Paragraph 4(3) is rewritten in section 923 of ITA 2007 and has been repealed. In error, the amendments to paragraph 4(4) omitted to refer to section 923 of ITA 2007. Arguably, that omission has inadvertently changed the effect of the law. Article 2(3) of the Order makes further consequential amendments to paragraph 4(4) of Schedule 23A to ICTA 1988 to remedy this omission.

7.3.3 Section 874 of ITA 2007 (duty to deduct sums representing income tax from certain payments of yearly interest) is based on section 349(2) of ICTA 1988. The requirement in section 349(2) of ICTA 1988 that the interest falls within Chapter 2 of Part 4 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA) or is chargeable to corporation tax under Case III of Schedule D was

omitted from section 874 of ITA 2007 as unnecessary. Paragraph 6E of Schedule 28AA to ICTA 1988 (provision not at arm's length) provides that, where interest paid exceeds the interest that would have been payable on an arm's length basis, the excess is not to be regarded as chargeable under Case III of Schedule D or Chapter 2 of Part 4 of ITTOIA. The result of the requirement in section 349(2) of ICTA 1988 mentioned above is that under the source legislation there is no duty to deduct a sum representing income tax from such an excess. It is not clear whether the omission of that requirement has changed the effect of the law and extended the scope of section 874. Article 3(3) of the Order resolves the matter by making express provision in paragraph 6E of Schedule 28AA to ICTA 1988 that there is no duty to deduct.

- 7.3.4 Subsection (2)(a) of section 396 of ITA 2007 (loan to buy interest in employee-controlled company) is based on section 361(4)(b) of ICTA 1988. It is unclear, however, whether the wording of the rewritten provision can be read as properly reflecting the provision of the source legislation, namely that, to qualify for relief, the shares may be acquired within 12 months after the company becomes employee-controlled, but not after the end of that period. Article 3(2) of the Order resolves the matter by substituting a revised section 396(2)(a) of ITA 2007.
- 7.3.5 Article 3(3) of the Order corrects an erroneous cross-reference in section 540 of ITA 2007. Subsection (3)(b) cross-refers to "section 261 of TCGA 1992". It is clear from section 505(3) of ICTA 1988, on which section 540(3) of ITA 2007 is based, and from section 540(5) of ITA 2007, that the cross-reference is intended to be to section 256(1) of TCGA 1992.
- 7.3.6 Section 816 of ITA 2007 is based on section 151(2) of, and paragraphs 2(1) and 3(1) of Schedule 26 to, Finance Act 2003. It defines "disregarded company income" for the purposes of the limits on liability to income tax of non-UK resident companies. An attempt in section 816(1)(c) and (d) of ITA 2007 to simplify the structure of the source provisions relating to transactions carried out through a broker or investment manager in the United Kingdom on behalf of a non-UK resident company has resulted in a change in the effect of the law, by narrowing the type of transactions carried out through an investment manager the income from which may be disregarded company income. Article 3(4) of the Order corrects this error by reinstating the structure of the source legislation in relation to investment managers and also, for consistency, in relation to brokers.
- 7.3.7 Subsection (3) of section 796 of ICTA 1988 is rewritten for income tax purposes in section 29 of ITA 2007. The subsection is omitted from ICTA 1988 by paragraph 193 of Schedule 1 to ITA

2007 and is repealed by Schedule 3 to ITA 2007. Section 277(1) of TCGA 1992 applies Chapters 1 and 2 of Part 18 of ICTA 1988, with modifications, for the purposes of capital gains tax. Chapter 2 of Part 18 of ICTA 1988 includes section 796. It is arguable that the repeal of section 796(3) of ICTA 1988 by ITA 2007 does not affect its continued application for the purposes of capital gains tax. But it is preferable for this to be made explicit and article 3(5) and (6) of the Order add the necessary clarifications in paragraph 193 of Schedule 1 to ITA 2007 and in Schedule 3 to ITA 2007.

8. Impact

- 8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has no adverse impact on business, charities or voluntary bodies.
- 8.2 There is no impact on the public sector.

9. Contact

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